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ABSTRACT

This module discusses several borrowing schemes to help students see more clearly the effects of borrowing money on both the lender and the borrower. They include borrowing from personal lenders, from "5-6" operators, and from credit unions. Three exercise sets with answers (one for each borrowing scheme), a short list of references, and a glossary are included. (JN)

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Borrowing Money

SE 046 256

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Borrowing Money

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BORROWING MONEY

PROJECT TEAM

Writer: Ma. Bella A. Dumas

Consultant: Josefina C. Fonacier

Reviewer: Dolores F. Hernandez

Project Coordinator: Vivien M. Talisayon

Project Assistant: Aurora B. Mendoza

Illustrator: Conrado M. Samia

Publications Staff: Arthur V. Abaloyan
Benedicto A. Artugue
Ester A. Bautista
Adelwisa D. Cachero
Camilo M. Encarnacion
Ruben L. Gabuat
Mario C. Gallardo
Regino L. Lamorena
Pedro A. Laurino
Renante M. Lunas
Erlando B. Mangaser
Guillerma F. Plata
Cesar M. Sagun

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La Transfiguracion Cooperative Credit Union, Palo, Leyte
And all the market vendors in some public markets in Metro Manila who were interviewed by the writer.

In anything we do, wise moves do count. This should hold true most especially when we borrow money.

On the one hand, if people only know how to save and avoid spending beyond that which they can afford, this type of activity would easily be avoided.

On the other hand, in times of emergency, when you cannot help but borrow money, you should know where and from whom to borrow in order to avoid regrets later. Very often, some people, in the guise of goodwill, come to offer you loans which are not only inviting in terms of the amount which you can borrow, but also on how easily and fastly you can get the amount. These operations, especially during times when you need money very badly, easily make you prey to the schemes of such people. However, you eventually find out in the end, that with the very high interest rates that they charge on the loan, you end up just paying the interest and only time can tell when you could pay back the loan completely.

This module then discusses in detail some of the borrowing schemes to help you see more clearly the effects of borrowing money on both the lender and the borrower.

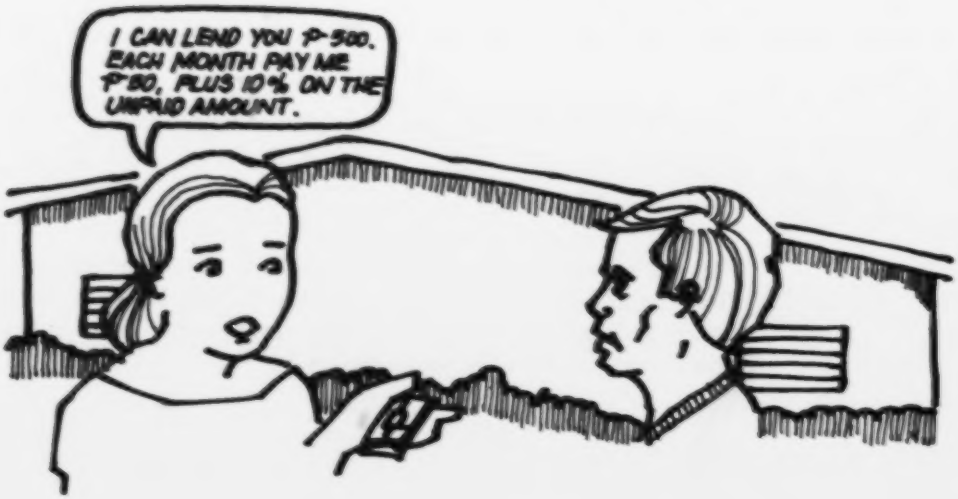
Borrowing Money

FROM PERSONAL LENDERS

Mang Jose needs money very badly. His son was hospitalized, but will be going out of the hospital tomorrow. He will have to pay ₱500.00 for the hospital bills and he does not have the money.

Let us study Mang Jose's options.

Option A. Mang Jose might borrow from Aling Julia.



The table below shows Mang Jose's schedule of payments if he borrows from Aling Julia.

After Month	Balance of Loan (Pesos)	Payment for Loan (Pesos)	Interest on Balance (Pesos)	Total Payment (Pesos)
1	500	50	500 X .1 = 50	50 + 50 = 100
2	500 − 50 = 450	50	450 X .1 = 45	50 + 45 = 95
3	450 − 50 = 400	50	400 X .1 = 40	50 + 40 = 90
4	400 − 50 = 350	50	350 X .1 = 35	50 + 35 = 85
5	350 − 50 = 300	50	300 X .1 = 30	50 + 30 = 80
6	300 − 50 = 250	50	250 X .1 = 25	50 + 25 = 75
7	250 − 50 = 200	50	200 X .1 = 20	50 + 20 = 70
8	200 − 50 = 150	50	150 X .1 = 15	50 + 15 = 65
9	150 − 50 = 100	50	100 X .1 = 10	50 + 10 = 60
10	100 − 50 = 50	50	50 X .1 = 5	50 + 5 = 55
TOTALS		500	275	775

At the end of the tenth month, Mang Jose would be able to pay the loan from Aling Julia fully. In addition to this, he would have paid Aling Julia a total interest of two hundred seventy five pesos. To get the interest rate for the whole loan, we have

$$\frac{275}{775} = 0.35 \text{ or } 35\% \text{ for 10 months}$$

or 3.5% per month

or 42% per year

Option B. Mang Jose would like to shorten the period of the loan.

1.1 How long will it take Mang Jose to pay the loan fully?

Let us now make the table showing the schedule of payments Mang Jose will have to make if he chooses this option.

After Month	Balance of Loan (Pesos)	Payment for Loan (Pesos)	Interest on Balance (Pesos)	Total Payment (Pesos)
1	500	100	500 X .1 = 50	100 + 50 = 150
2	500 − 100 = 400	100	?	?
3	400 − 100 = 300	100	300 X .1 = 30	100 + 30 = 130
4	300 − 100 = 200	100	200 X .1 = 20	?
5	200 − 100 = 100	100	?	?
TOTALS		?	?	?

1.2 How much total interest would Mang Jose pay if he chooses this option?

1.3 What is the interest rate for the 5 months?
1.4 What would the average interest rate be per month?
1.5 What would this interest rate be per year?
1.6 Is this option better than option A? Explain your answer.

Option C. Mr. Cruz offered still another arrangement.

1.7 How long will it take Mang Jose to pay the loan fully?
1.8 Complete the table below.

After Month	Balance of Loan (Pesos)	Payment for Loan (Pesos)	Interest on Balance (Pesos)	Total Payment (Pesos)
1	500	100	500 X .08 = 40	100 + 40 = 140
2	500 − 100 = 400	100	400 X .08 = 32	100 + 32 = 132
3	?	100	?	?
4	?	100	?	?
5	?	100	?	?
TOTALS		?	?	?

1.9 How much total interest would Mang Jose pay if he chooses this option?
1.10 What would this interest be equal to per month?
1.11 What would this interest be equal to per year?

1.12 If you were Mang Jose and you had to choose among options A, B, or C, which would you choose? Explain.

Let us now summarize the three options from which Mang Jose will make a choice.

Amount of Loan = ₱500.00

Option	Terms On Loan	No. of Monthly Payments	Total Amount of Interest	Interest Rate Per Month	Total Interest Rate Per Year
A	₱50.00 a month plus 10% on the unpaid amount	10	₱275.00	3.5%	42%
B	₱100.00 a month plus 10% on the unpaid amount	5	₱150.00	6%	72%
C	₱100.00 a month plus 8% on the unpaid amount	5	₱120.00	4%	48%

1.13 Consider Options A and B. The amount of loan and the interest rate are equal, but the monthly payments differ. Which one gives a bigger interest rate?

1.14 Consider Options B and C. The amount of loan and the monthly payments are equal, but the interest rates differ. Which one gives a bigger interest rate?

1.15 Assuming that the amount of loan remains constant, what is the relation between the terms on the loan and the corresponding rate of interest?

You have seen in the preceding table that for the same amount borrowed, the average monthly rate of interest on the loan is bigger when the monthly payment is bigger, or, when the loan is paid off in a shorter period.

Assuming then that

the same amount is borrowed,
at the same rate of interest on the amount borrowed,
and with the borrower giving equal monthly payments on a loan,

money lenders earn more when people borrow from them for shorter periods (bigger equal monthly payments) than for longer periods (smaller equal monthly payments).

Exercises Set 1

From whom will Aling Julia earn more? Explain your answer.

a) Mang Karyo borrowed ₱600.
He agreed to pay ₱50 a month for the loan.
He also agreed to pay 20% interest a month on the unpaid amount.

Mang Juan borrowed ₱600.
He agreed to pay ₱120 a month for the loan.
He also agreed to pay 20% interest a month on the unpaid amount.

b) Aling Charing borrowed ₱800.
She agreed to pay ₱200 a month for the loan.
She also agreed to pay 20% interest a month on the unpaid amount.

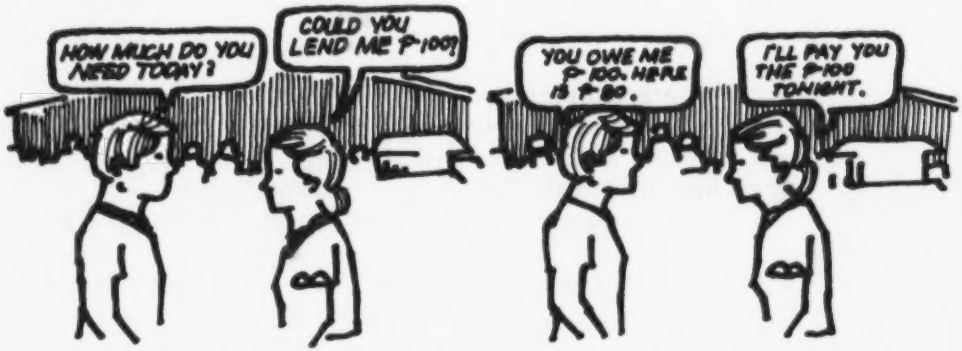
Aling Rose borrowed ₱600.
She agreed to pay ₱200 a month for the loan.
She also agreed to pay 20% interest a month on the unpaid amount.

c) Myrna borrowed ₱200.
She agreed to pay ₱10 a month for the loan.
She also agreed to pay 20% interest on the unpaid amount.

Linda borrowed ₱100.
She agreed to pay ₱20 a month for the loan.
She also agreed to pay 20% interest on the unpaid amount.

FROM "5-6" OPERATORS

Early in the morning . . .



Aling Juaning owes Mang Loloko a hundred pesos but actually got only eighty pesos! Why is this so?

A similar situation is when one borrows five pesos from a friend, receives four pesos, but pays back five pesos at the end of the day.

But why "5-6"? You borrow five pesos, you pay back five pesos. Where does six come in? Here's why:

*Amount Borrowed	₱5.00	
Amount Actually Received	4.00	
Interest On the Amount Borrowed and Paid in Advance	₱1.00	(₱5.00 − ₱4.00)
Amount Actually Paid Back	₱5.00	
*Total Amount Paid Back	₱6.00	(₱5.00 + ₱1.00)

So, for the five pesos which you borrow, you pay an interest of one peso. Such an interest is paid in advance, that is, at the time you borrow the money.

Let us find out what percent of five pesos is one peso:

₱1.00 ÷ ₱5.00 = 0.20 or 20%

Thus, under a "5-6" arrangement, the interest which is paid in advance is equal to twenty percent (20%) daily.

Let us study the other example where Aling Juaning borrowed one hundred pesos from Mang Loloko, but received only eighty pesos.

Amount Borrowed	₱100.00	
Interest Paid in Advance	₱ 20.00	(₱100.00 X .20)
Amount Actually Received	₱ 80.00	(₱100.00 − ₱20.00)
Amount Actually Paid Back	₱100.00	
Total Amount Paid Back	₱120.00	(₱100.00 + ₱20.00)

This practice first started with the borrower paying back the loan after some days or even weeks. Now, certain money lenders have been lending money using the same procedure but the money has to be paid back immediately at the end of the day, or else they will not lend to that person again.

The table below shows different amounts borrowed from a "5-6" operator per day with the corresponding payment made at the end of the day.

Amount borrowed from operator at start of day (A)	Interest in advance deducted from amount borrowed from operator at start of day (B)	Amount actually received from operator at start of day (C = A − B)	Amount paid back to operator at end of day (D)	Total amount paid back to operator in one day (E = B + D)
₱ 5.00	₱ 1.00	₱ 5.00 − 1.00 = ₱ 4.00	₱ 5.00	₱ 1.00 + 5.00 = 6.00
10.00	2.00	10.00 − 2.00 = 8.00	10.00	2.00 + 10.00 = 12.00
20.00	4.00	20.00 − 4.00 = 16.00	20.00	4.00 + 20.00 = 24.00
30.00	6.00	30.00 − 6.00 = 24.00	30.00	6.00 + 30.00 = 36.00
40.00	8.00	40.00 − 8.00 = 32.00	40.00	8.00 + 40.00 = 48.00
50.00	10.00	50.00 − 10.00 = 40.00	50.00	10.00 + 50.00 = 60.00

Suppose you borrow fifty pesos at the start of the day and pay back this amount at the end of the day. And you do this each day for 30 days. Here is what you pay as interest each day:

₱50.00 X 0.20 = ₱10.00

Here's what you pay as interest in 30 days:

₱10.00 X 30 = ₱300.00

If you pay an interest rate of 20% each day in 30 days, you will pay an interest rate of

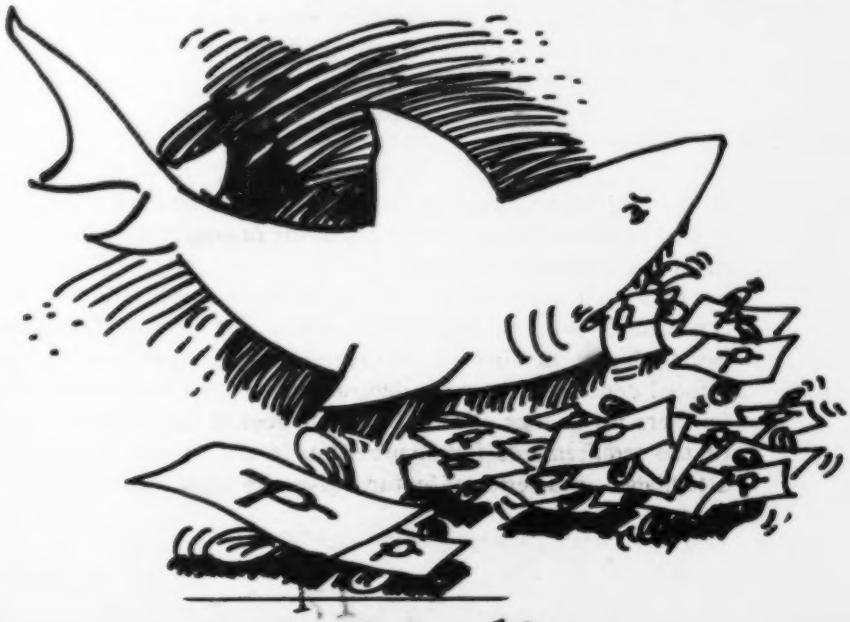
20% X 30 = 600%

Here's the rate of interest you pay after twelve months or one year:

600% X 12 = 7200%!

At present the maximum interest rate allowed by law is 18% per year. Definitely, the interest rate of the "5-6" operator is much higher than the present legal lending rate.

Many lenders who charge more than 18% annual interest are called loan sharks. A "5-6" operator is a loan shark. Look back at the first section. Is Aling Julia a loan shark? What about Mr. Cruz?



Exercises Set 2

1. Complete the table below.

Amount borrowed from operator at start of day (A)	Interest in advance deducted from amount borrowed from operator at start of day (B)	Amount actually received from operator at start of day (C)	Amount paid back to operator at end of day (D)	Total amount paid back to operator in one day (E = B + D)
a. ₱ 60.00				
b. 70.00				
c. 80.00				
d. 90.00				
e. 120.00				
f. 140.00				
g. 150.00				

2. Aling Juaning needs thirty pesos earnings from the vegetables. She borrows sixty pesos from a "5-6" operator for buying some vegetables. How much should she sell her vegetables?

3. Aling Juaning borrowed eighty pesos from a "5-6" operator for buying some vegetables. She sold these vegetables for one hundred pesos. Did she earn or lose? How much did she earn or lose?

4. If you borrow two hundred pesos each day from a "5-6" operator for thirty days, how much interest would you have paid this operator after thirty days?

FROM CREDIT UNIONS

In the Philippines, there are organizations which have a specific aim – that of giving loans to members of the organizations who need money for a reasonable purpose.

One such organization is a cooperative credit union. This is an organization where the members help to put up a fund available for borrowing by members of the organization. Such an amount is called a fixed deposit, meaning, a deposit made by a member which should be there for as long as he is still a member of that organization. One of the requirements for membership in this organization is faithful attendance in a series of lectures given by the officers of the credit union.

This organization grants three different kinds of loan to its members namely – productive loan, provident loan and petty cash.

The **productive loan** can be made by a member of the credit union who wants to start an income generating project, like for example, a sari-sari store, a meat or fish stand.

The **provident loan** can be made by a member who needs money to pay for the school fees of his children, or for hospital fees or to pay for other loans with higher interest than that which is exacted by the credit union itself.

The **petty cash** is granted to a member of the credit union who needs cash immediately. This is at most a hundred pesos only.

For the productive and provident loans a maximum amount is set by the board members of the credit union. Also when a member wishes to make a loan, this should not exceed 1 1/2 times his fixed deposit.

Loans from credit unions should be paid within one year. Each periodic payment includes the interest due. Interest rates vary among credit unions, but they are all within the legal limit.

Suppose Aling Juaning has a fixed deposit of five hundred pesos (₱500.00). She can make a loan of seven hundred fifty pesos (₱750.00).

Date of Payment	Balance of Loan	Interest Due	Payment	Payment on Loan
Aug. 1983	750	750 X .01 = 7.50	75	67.50
Sept. 1983	(750 – 67.50) = 682.50	682.50 X .01 = 6.83	75	68.17
Oct. 1983	(682.50 – 68.17) = 614.33	614.33 X .01 = 6.14	75	68.86
Nov. 1983	(614.33 – 68.86) = 545.47	545.47 X .01 = 5.46	75	69.54
Dec. 1983	(545.47 – 69.54) = 475.93	475.93 X .01 = 4.76	75	70.24
Jan. 1984	(475.93 – 70.24) = 405.69	405.69 X .01 = 4.06	75	70.94
Feb. 1984	(405.69 – 70.94) = 334.75	334.75 X .01 = 3.35	75	71.65
March 1984	(334.75 – 71.65) = 263.10	263.10 X .01 = 2.63	75	72.37
April 1984	(263.10 – 72.37) = 190.73	190.73 X .01 = 1.91	75	73.09
May 1984	(190.73 – 73.09) = 117.64	117.64 X .01 = 1.18	75	73.82
June 1984	(117.64 – 73.82) = 43.82	43.82 X .01 = 0.44	44.26	43.82
TOTALS		44.26	794.26	750.00

Let us say that she made the loan in July and that she makes equal payments of seventy five pesos (₱75) each month at 1% per month. Some credit unions would record Aling Juaning's transactions this way.

After 11 months, Aling Juaning will pay back her loan. Note that in the last month only ₱44.26 would be needed to complete payments; also this is the total interest paid for the whole period of the loan.

Let us find out what percent of the loan will Aling Juaning pay as total interest rate.

₱44.26	÷	₱750	=	.059 or 5.9%
(Interest)		(Loan)		(Interest Rate)

Suppose Aling Juaning makes equal monthly payments of ₱125 also at 1% per month. Let us see how the loan would behave.

Date of Payment	Balance of Loan	Interest Due	Payment
Aug. 1983	750	750 X .01 = 7.50	125
Sept. 1983	(750 + 7.50) − 125 = 632.50	632.5 X .01 = 6.33	125
Oct. 1983	(632.5 + 6.33) − 125 = 513.83	513.83 X .01 = 5.14	125
Nov. 1983	(513.83 + 5.14) − 125 = 393.97	393.97 X .01 = 3.94	125
Dec. 1983	(393.97 + 3.94) − 125 = 272.91	272.91 X .01 = 2.73	125
Jan. 1984	(272.91 + 2.73) − 125 = 150.64	150.64 X .01 = 1.51	125
Feb. 1984	(150.64 + 1.51) − 125 = 27.15	27.15 X .01 = 0.27	27.42

Let us return to Mang Jose whom we met in the beginning of this module. He needs to borrow ₱500. Suppose that he is a member of a Credit Union, and this Union charges 1% interest per month on the unpaid balance of a loan.

3.1 What kind of a loan should Mang Jose apply for?

3.2 If Mang Jose gives ₱50 per month to pay back his loan, how would his record of payments look like?

3.3 Mang Jose has a fixed deposit of only ₱400. Would he be qualified to apply for a ₱500 loan?

Exercise Set 3

1. Lita has a fixed deposit of ₱350 with the credit union. How much loan can she possibly make?
2. Joseph borrowed ₱250. He regularly pays the credit union ₱45 a month. He also pays 1% monthly interest on the unpaid Amount. After how many months would he be able to pay his loan and the interest on it?
3. Aling Rosa borrowed ₱750. She promises to pay this in equal amounts of sixty pesos a month. She also agreed to pay 1% monthly interest on the unpaid amount. Make a breakdown of such payments for Aling Rosa.
4. Mr. Juan borrowed ₱350 payable in one year at 6% interest per year. How much would be the interest on his loan? How much would he pay in all in one year?
5. Mrs. Carlos borrowed ₱100 payable in one year at 6% interest per year. How much will Mrs. Carlos' monthly payment be?

SOMETHING TO THINK ABOUT

The main reason why people go to usurers is the limited capability of banks and finance companies to provide funding assistance to people who are in immediate need of cash. The multi-product loan portfolio of any bank or financing company is usually saturated with several types of loans. An ordinary person's loan application does not carry much weight with the lending institution as compared to a bigger company's application which can guarantee collaterals. Very often, an individual borrower's ability to pay back the loan is always under question. And in many cases, his financing requirement is too small for banks' and finance companies' operations.

This is the state of the ordinary individual. He is considered a doubtful credit risk.

What we need in our country today are financing organizations which can help these victims of usury – doing more than purely operate for profit. We call on them for the sake of social justice.

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GLOSSARY

Balance of Loan – amount left of the loan after a borrower pays back a certain amount.

Collateral – something which belongs to the borrower which could be used by the borrower as payment for a loan once he is not able to pay it back.

Credit Risk – a borrower who cannot give any collateral.

Fixed Deposit – (see p. 10 of the module).

Interest – the price paid for borrowing money generally expressed as a percentage of the amount borrowed paid in one year.

Interest in Advance – interest paid upon borrowing.

Loan – money lent at interest

Loan Portfolio – amount set aside by the bank for lending.

Petty Cash – (see p. 11 of the module).

Production Loan – (see p. 11 of the module).

Provident Loan – (see p. 11 of the module).

Usurer – a lender who charges very high interest rates or money borrowed from him (beyond legal rates).

Usury – the practice of a lender of charging very high interest rates on money borrowed.

ANSWER KEY

Exercises Set 1

a) Mang Karyo – about 5% a month
Mang Juan – about 8% a month

b) Aling Charing – about 12% a month
Aling Rose – about 13% a month

c) Myrna – about 10% a month
Linda – about 12% a month

Exercises Set 2

1.

	B	C	D	E
a	₱12.00	₱48.00	₱60.00	₱72.00
b	14.00	56.00	70.00	84.00
c	16.00	64.00	80.00	96.00
d	18.00	72.00	90.00	108.00
e	24.00	96.00	120.00	144.00
f	28.00	112.00	140.00	168.00
g	30.00	120.00	150.00	180.00

2. ₱102.00

3. Aling Juaning earned ₱4.00.

4. Six hundred percent (600%)

Exercises Set 3

1. at most five hundred twenty-five pesos (₱525.00)

2. six (6) months

4. ₱21; ₱371

5. about ₱8.35